TRANSMITTAL SLIP | 4 SEP 1986

TO: ADD/EBS

ROOM NO. 5S17 | BUILDIN [redacted]

STAT

REMARKS:

FYI

FROM: C/PMCD

ROOM NO. 5N11 | BUILD [redacted] | EXTENSION [redacted]

STAT
STAT

FORM NO. 241
1 FEB 56

REPLACES FORM 36-8
WHICH MAY BE USED.

(47)

TPF&C UPDATE

C/PMCD
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Budg

August 1986

HOUSE-SENATE CONFEREES VOTE FOR TAX REFORM

The most sweeping overhaul of U.S. tax laws in half a century -- which was agreed to by the House-Senate conferees on Saturday night, August 16 -- will have a major impact on compensation and benefit programs.

After an eleventh-hour bombshell from the revenue estimators (on the previous Thursday night the bill was declared $17 billion shy of tax neutrality), the conferees made some quick, hard decisions that put the bill back on track. During the next few weeks, the staff of the Joint Committee on Taxation will draft the Conference Report and exact language of the bill. It is expected to be enacted shortly after Congress reconvenes on September 8.

In general, the conferees followed the theory of the Senate bill: low tax rates and few individual preferences. They also adopted many of the Senate provisions on employee benefits. The major elements of this compromise bill are:

- Ordinary income and capital gains will be subject to a maximum rate of 28% (with a higher marginal rate of 33% for certain upper income taxpayers). Many deductions will be eliminated, such as the deduction for interest associated with the purchase of consumer goods.
- Corporate-sponsored tax-free benefits remain tax-free. But new, tighter discrimination rules will apply to qualified plans and tax-favored welfare plans. These rules are still being developed by the Congressional staff.
- Contributions to 401(k) plans will be limited to $7,000. Plans will be subject to a tighter ADP test and will not be available in the future for tax exempt and state and local employees. The Senate bill's provision permitting an additional $2,500 contribution for ESOPs was dropped.
- ESOPs continue to enjoy favorable treatment as under current law. They will also be able to recover pension surplus free of income and excise tax for a limited period of time.
- IRAs will survive, but on a non-deductible basis for high-income taxpayers covered by a qualified plan.

(continued)

- Section 415 benefit limits will remain at $90,000 and $30,000, but with steep early retirement reductions and a 10-year phase-in for undefined "abusive" amendments. It appears that the conferees also adopted an excise tax for distributions over $112,500.

- New integration rules will apply to retirement plans, and the Congressional staff may add some minimum benefit requirements (to protect against a reduction in benefits below old levels) in the final bill.

- Full vesting of benefits will be required after five years (with a graded alternative).

- Early distributions from qualified plans will be subject to a 10% excise tax. Various grandfathering provisions on taxation of distributions have been clarified.

With much of this legislation becoming effective in 1987, employers and employees should prepare now for a dramatic shift in the taxation of compensation and in the design of many employee benefit plans.